

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

Islamic Banking

Concepts and Understanding

Orientation Session (Part ONE)

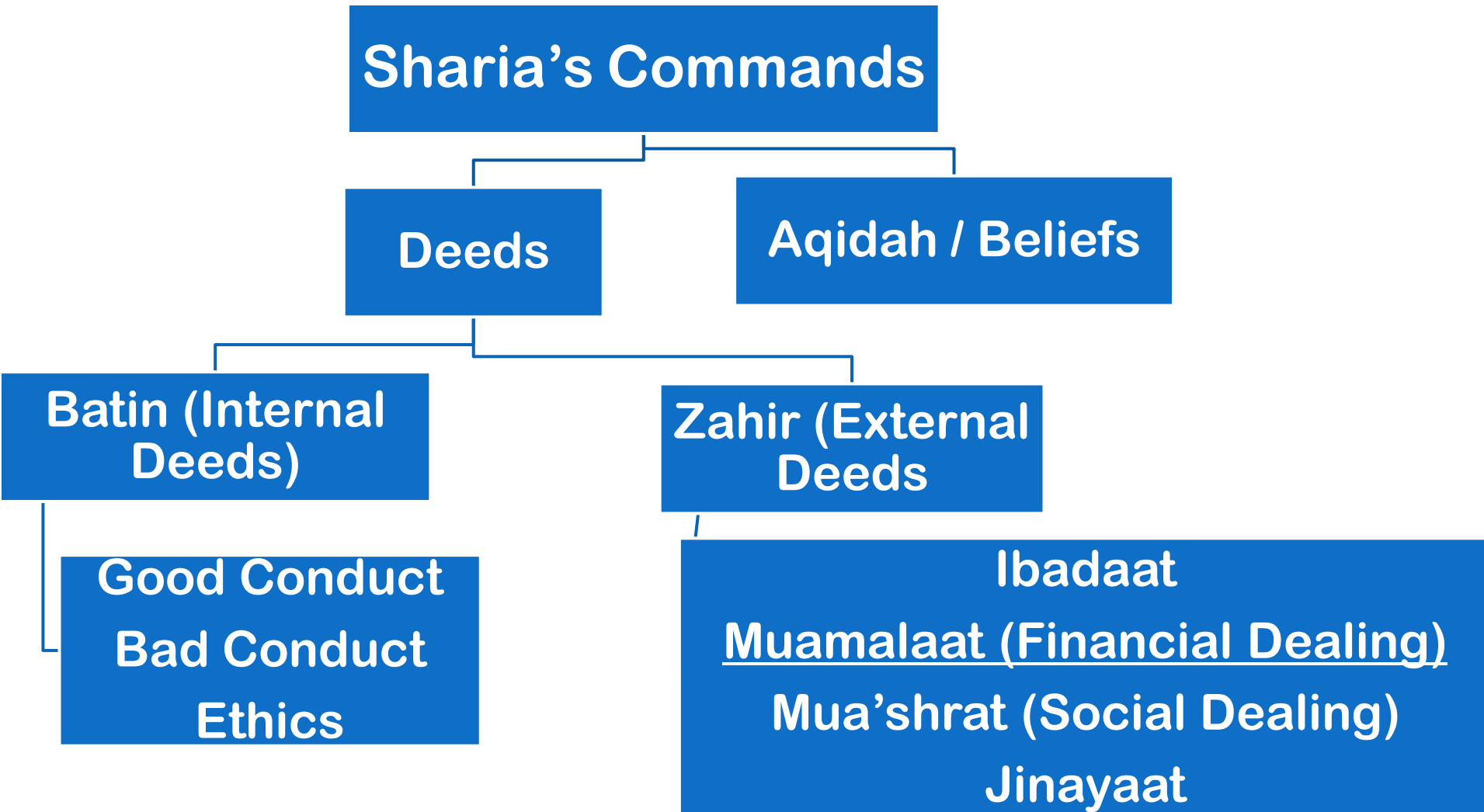
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Shari 'a Advisor

Summit Islamic Banking



The Organogram of Sharia's Commands



Rulings of Shari 'a

• TYPE

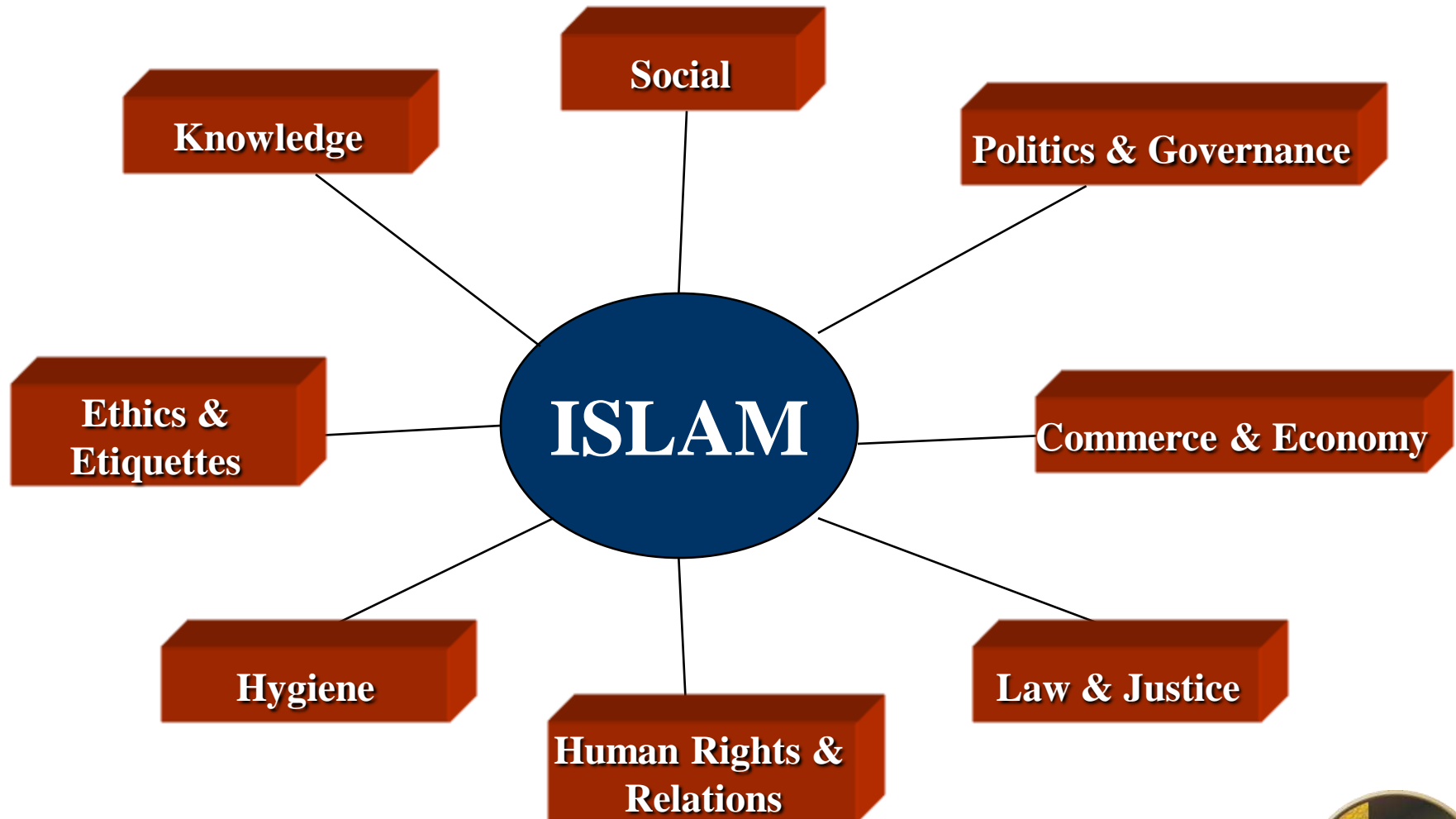
- Fard / Wajib (Obligation)
- Mandoob (Recommended)
- Haram(Prohibition)
- Makrooh (Discouraged)
- Mubaah (Permissible)

• ACTION

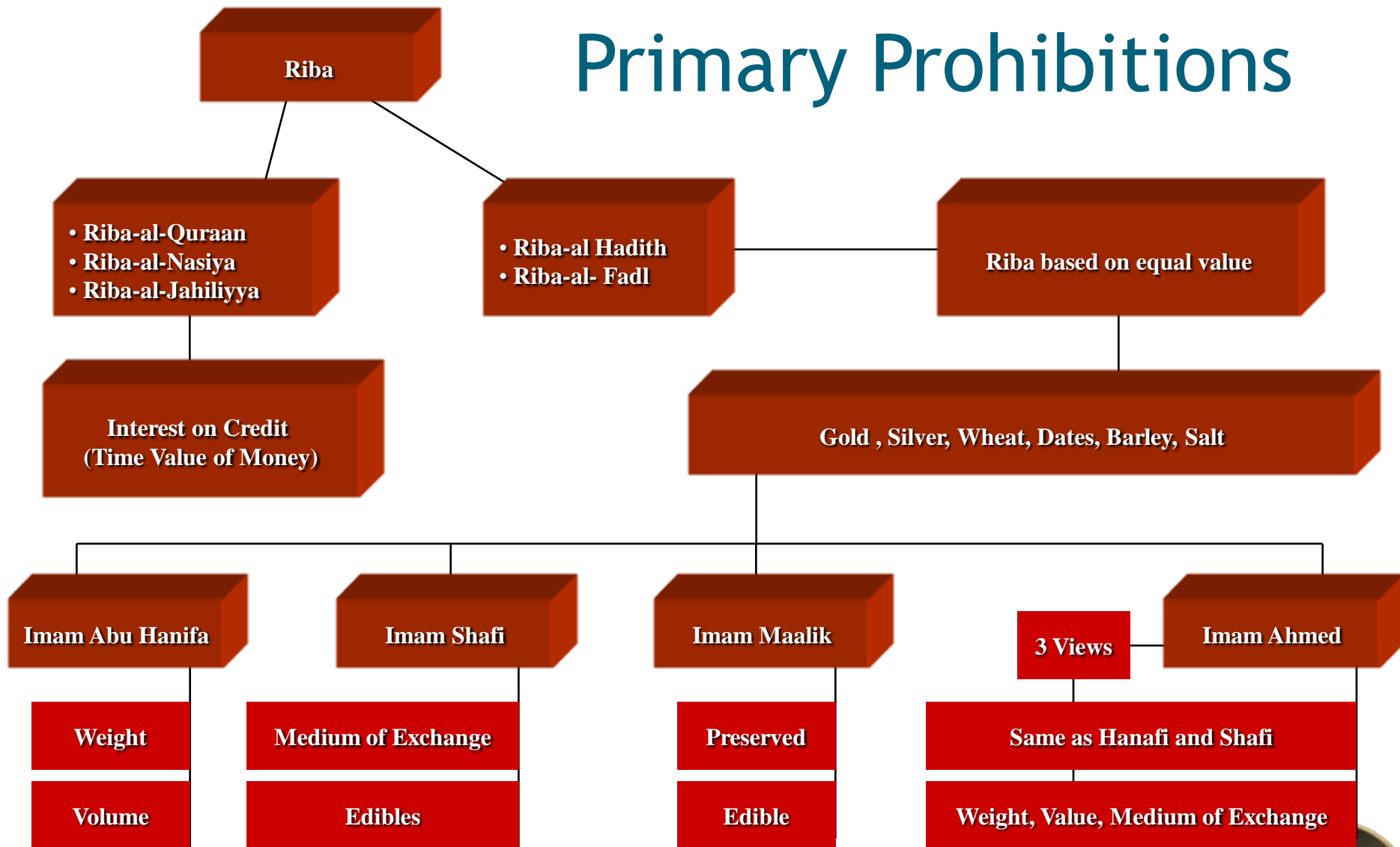
P: Rewarded	NP: Punished
P: Rewarded	NP:Not Punished
P: Punished	NP: Rewarded
P: Not Punished	NP: Rewarded
P: Not Rewarded	NP: Not Punished



What is Islam?



Primary Prohibitions



General Principles of Contracts

1. Free Mutual Consent
2. Lawfulness of Subject Matter
3. Legality of Motivating Cause
4. Prohibition of Gharar (Uncertainty)
5. Prohibition of Riba
6. Prohibition of Qimar (Gambling) & Maysir (Games of Chance)



Riba - Unanimity

- Unanimity on Riba Prohibition;
- Problem then?
- Interpretation
- Consensus (Verses 11:278, 279 give principle defining Riba).

يَا أَيُّهَا الَّذِينَ ءَامَنُوا اتَّقُوا اللَّهَ وَذَرُوا مَا بَقِيَ مِنَ الرِّبَا إِن كُنْتُمْ مُّؤْمِنِينَ

“O you who believe. Fear Allah, and give up the Riba that remains outstanding if you are (in truth) believer”. (11:278).



Riba - Unanimity (Contd)

فَإِنْ لَّمْ تَفْعَلُوا فَأْذَنُوا بِحَرْبٍ مِّنَ اللَّهِ وَرَسُولِهِ ۖ

“If you do not do so, then be sure of being at war with Allah and his Messenger. But, if you repent, then you have your principal”. (11:279)

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

Those who protested and argued that lending on interest was like an act of trade, were admonished through revelation that while ‘trade’ was permitted, ‘riba’ was forbidden and in loan transactions they were entitled to their principal sums only.



قالوا: سواء علينا ان زدنا في اول البيع، او عند محل المال
فهما سواء فذلك قوله: (قالوا انما البيع مثل الربوا): لقولهم:
هن زدنا في اول البيع او عند محل المال، فهما سواء

- They used to say that it is all equal whether we increase the price in the beginning of the sale, or we increase it at the time of maturity. Both are equal. It is this objection which has been referred to in the verse by saying “They say that the sale is very similar to Riba.” (Ibn-Abi-Hatim)



Definition of Riba

- Earning any kind of profit on any debt falls under the category of RIBA as defined in the Hadith

كل قرض جر منفعة فهو ربا

- Any stipulated profit on any debt is Riba



Reward of Trade Activities

- Islam encourages trade and business activities
- Allah (SWT) has ordained in Holy Quran
- “Allah has permitted trade and prohibited Riba”
- HADITH إِنَّكَ أَنْ تَذَرَ وَرَثَتَكَ أَغْنِيَاءَ خَيْرٌ مِنْ أَنْ تَذَرَ لَهُمْ عَائِلَةً يَتَكَفَّفُونَ النَّاسَ
 - “If you leave behind wealthy heirs, it’s better than that of leaving them needy and dependent on others and under their control”



Reward of Trade Activities

- Prophet (SAW) once said:
“An honest and trustworthy trader on the day of judgment will be among Siddiqueen”
- Prophet (SAW) also encouraged Shirkah in various maxims and sayings.
- Prophet (SAW) once said that Allah (SWT) has stated:
“He will become a partners in a business between two Mushariks until they indulge in cheating or breach of trust (Khayanat)



Purifying Source of Income

- The body which is nourished by non-pure sources is bound to hellfire.
- On the day of Judgment, a person will not be moved from the place which he stands until he is asked about the sources of his income, and the ways he spent it.
- Purifying the source of ones' nourishment is one of the important reasons for the acceptance of supplications by Allah.



Principles of Islamic Tijaraat

- Qard a virtuous act – Not a business.
- Prohibition of Riba and Gharar; permission of trading.
- All gains to principal not prohibited.
- Deciding Factor: nature of transaction and process.
- Entitlement of profit: liability of risk of loss with the capital itself; (Al Kharaj bil Daman)
 - **Profit to be earned by sharing risk and reward of ownership through pricing of goods, services or benefits.**
 - **Concept of Time Value of Money in Islam**



Principles of Islamic Finance (Contd)

- **Ability to cause ‘value addition’.**
- **Differentiating: Trading, loaning and leasing**
- Ownership Transfer in: Sale of assets, Loans and Leasing;
- Any thing which cannot be used without consuming its corpus, cannot be leased out like money, edibles, fuel, etc.
- Taking rent on leasing of asset permissible while rent on loan is prohibited.
- Repayment of loan- Must.
- Husan al qada: Repaying a loan in excess of the principal.
- Debt contracts cannot be sold at discount. 18



Islamic Banking or Riba Free banking ?

- Banking encompassing Islamic injunctions
- To avoid:
 - Riba –Earning returns from a loan contract or Selling debt contracts at discount
 - Gharar – Absolute Risk or Excessive uncertainty in contracts, Gambling and chance-based games (Qimar)
 - General Prohibitions
 - Unethical practices
- Shariah Compliance & Prudent Banking
- Achieving the goals and objectives of an Islamic economy.



What Distinguishes Islamic Banking ?

- All transactions are asset-based
- It is socially-responsible banking
- Because it operates under Shariah restrictions
- Does not permit financing of prohibited goods / Industries
- It starves evil (Riba) out of the society



Distinguishing Features



Theoretical Comparison

CONVENTIONAL BANKING

- Is based on interest.
- Deals in money or papers.
- Is based on fixed return on both Sides of the balance sheet.
- Does not involve itself in trade and business

ISLAMIC BANKING

- Is based on profit or rent
- Deals in assets.
- Is based on profit sharing on deposits side, and on profit on assets side.
- Actively participates in trade and production



Distinguishing Features

CONVENTIONAL BANKING

- Conventional banking prices money
- Depositors get a fixed rate regardless of the bank's profitability, thus insulating them from the bank's true performance

ISLAMIC BANKING

- Islamic banking prices goods and services
- Profit is shared with the depositor, higher the bank's profit, higher the depositors income



Functioning of Banks

Standard products

Conventional

Deposits

Loans

Islamic

- Investment (similar to shareholder funds)
- Financing /Sale/ partnership

2. Focus on increasing net margin (difference between amounts received on advances and paid on deposits in respect of conventional banks)
3. Other income
 - Opportunities for growth
 - No capital required
4. Innovation and structuring



Fundamental Differences between Islamic Banks vs Conventional Banks

- Halal Procedures (e.g. No overdrafts, credit cards – buy & sell)
- No Interest
- No Uncertainty
- No Speculation
- No Unlawful Products
- No Unlawful Services

Monitored by a
Shariah Supervisory Board

Shariah
Audit
Reports

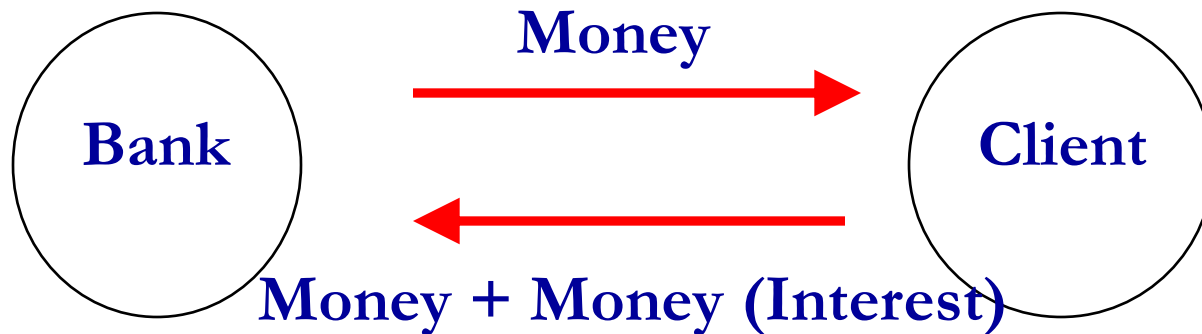
Internal
Shariah
Supervisors



Theoretical Comparison

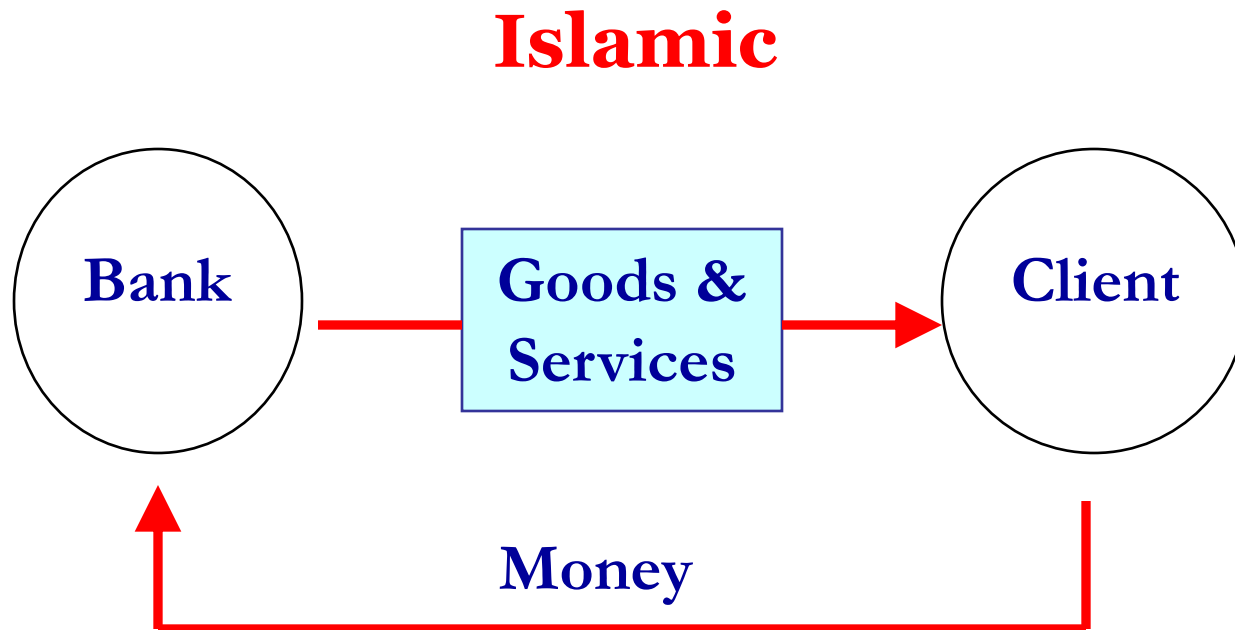
Basic Difference between Islamic and Conventional Modes of Finance

Conventional



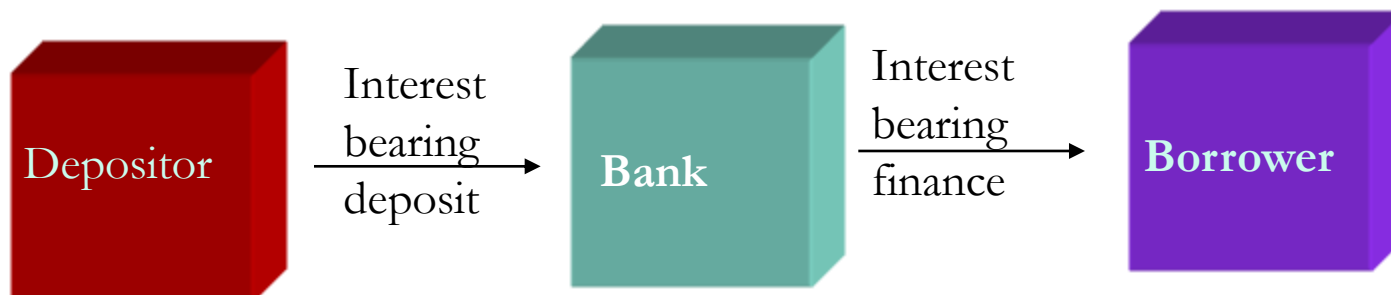
Theoretical Comparison

Basic Difference between Islamic and Conventional Modes of Finance



Conventional vs Islamic Banking

Conventional Bank



Islamic Banking



- Riba – Interest
- Gharar (Uncertainty)
- Prohibited activities / commodities

- Mobilisation of funds
- Investment Activities



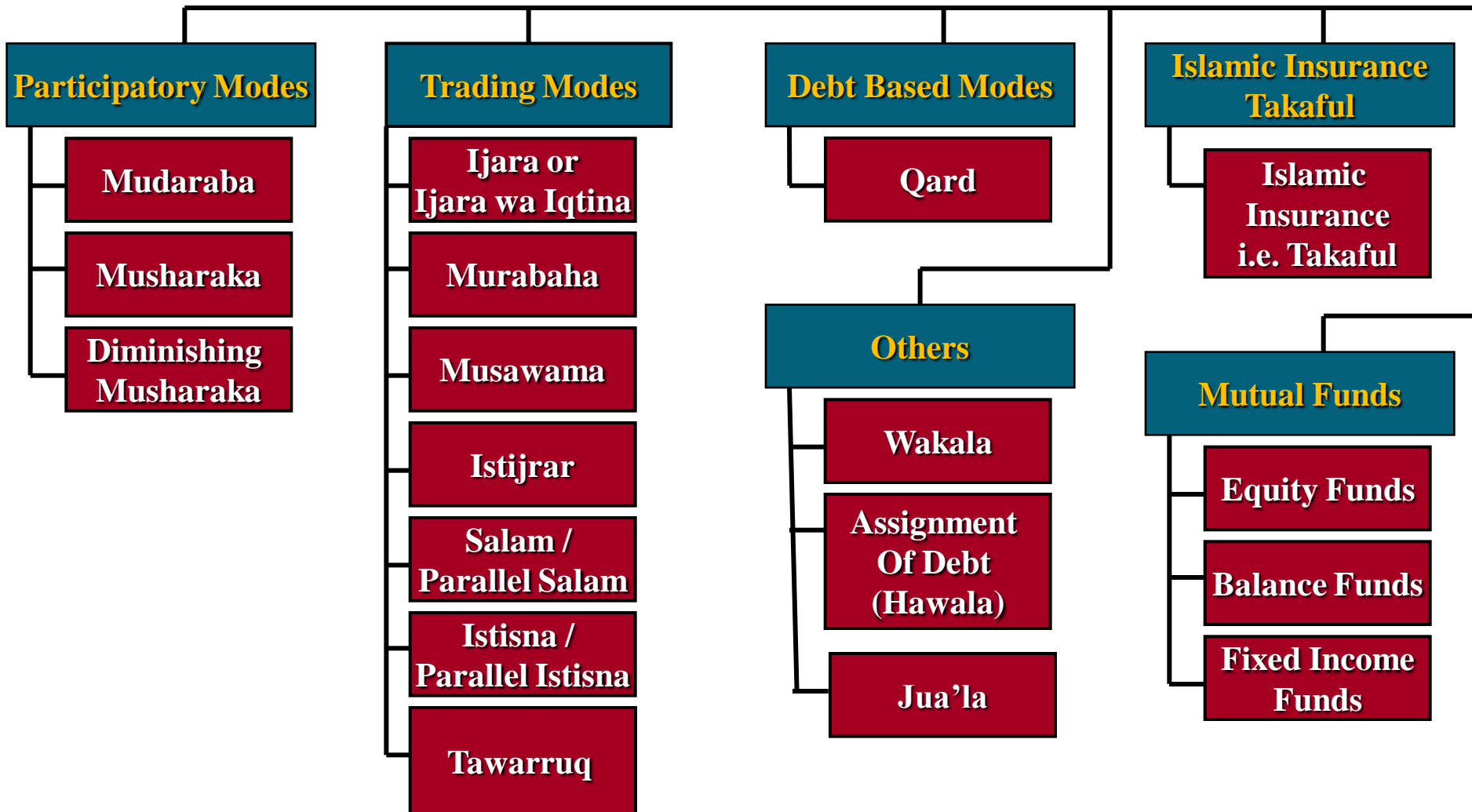
Main Financial Contracts

- A. Debt creating Modes (Low Risk Category)
 - Qard Al-Hasan (interest-free loan)
 - Muajjal (Price deferred sale)
 - Murabaha and Musawama
 - Salam (Commodity sale)
 - Istisna'a
- B. Semi-debt Modes
 - Ijara
- C. Sharing or Non-debt Modes (Full Risk Category)
 - Musharaka (Close to Venture Capital)
 - Specific Purpose Mudaraba
 - General Purpose Mudaraba

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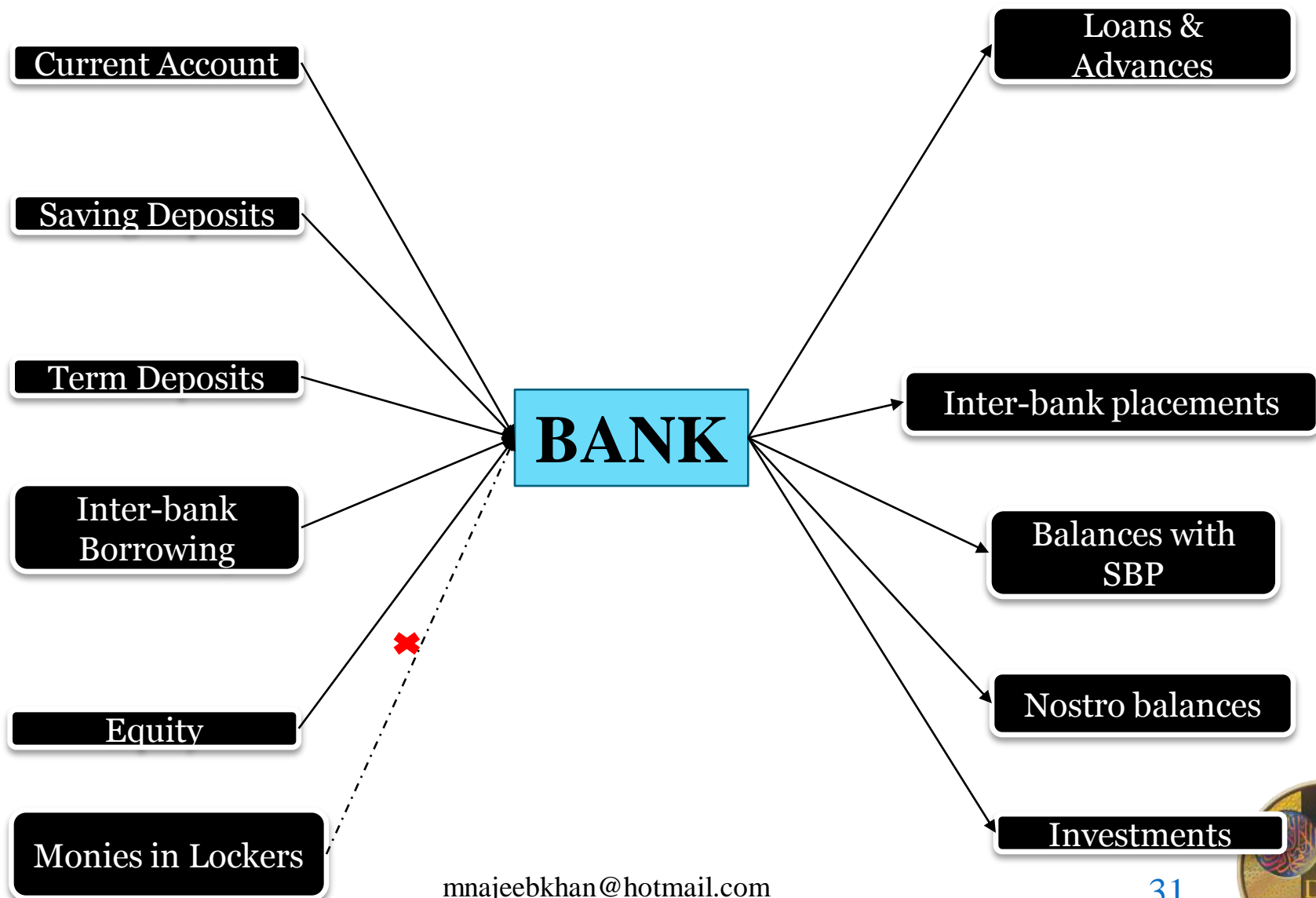


Modes of Islamic Finance Instruments

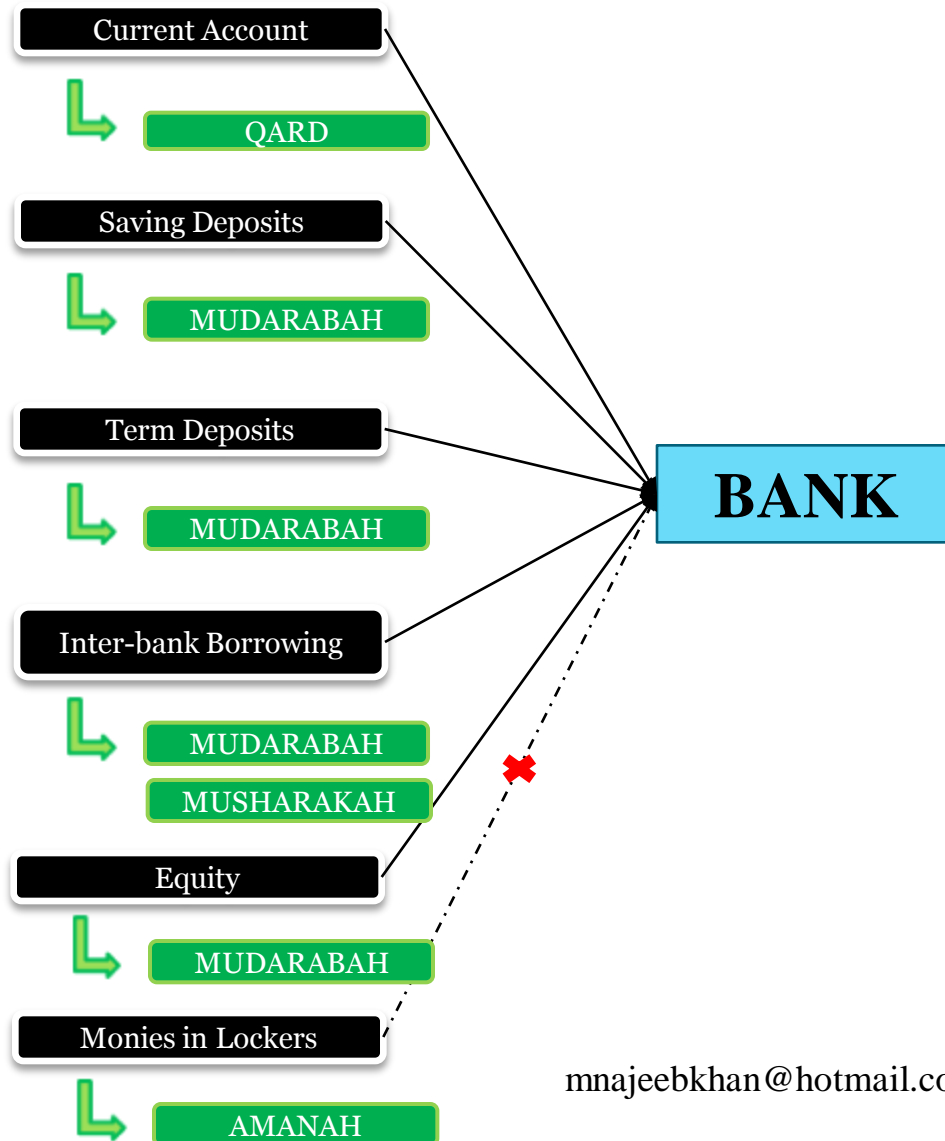


SOURCES of funds

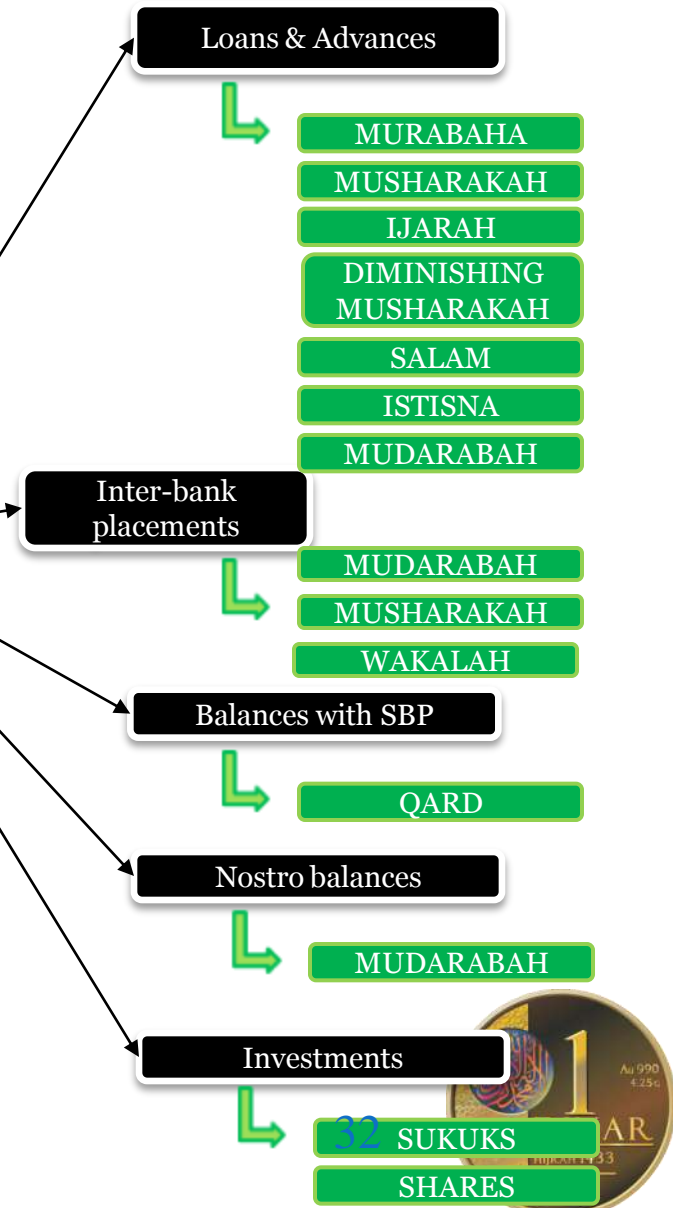
APPLICATION of funds



SOURCES of funds



APPLICATION of funds



جزاك الله خيرا



Islamic Banking

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